

## COMMENT LETTER

March 15, 2007

# ICI Comment Letter on IOSCO Consultation on Soft Commissions (pdf)

March 15, 2007 Ms. Pamela Vulpes IOSCO General Secretariat C/ Oquendo 12 28006 Madrid Spain RE: Comment on Consultation Report on Soft Commission Arrangements Dear Ms. Vulpes: The Investment Company Institute<sup>1</sup> welcomes the IOSCO Technical Committee's assessment of the value that soft commission arrangements can provide to investors in collective investment funds. As the Technical Committee recognizes, soft commission arrangements can facilitate fund managers' access to research and other services that enhance investment decisions for the benefit of investors. We largely agree with the Technical Committee's appraisal of the key issues relating to soft commission arrangements, and we strongly support the Technical Committee's decision to monitor changes in relevant law before attempting to develop general principles in this important area. We agree with the Technical Committee that fund managers must manage potential conflicts of interest to ensure that soft commission arrangements operate in the interests of investors. As recognized in the Consultation Report on Soft Commissions, national regulators employ various combinations of fiduciary principles and oversight, limitations on the services that may be obtained with soft commissions, and disclosure mandates to effectively address potential conflicts. Our views on each of these regulatory approaches are briefly described below.

**Fiduciary Principles and Oversight.** The application of fiduciary principles helps ensure that fund managers make appropriate use of soft commissions. Fund managers with a fiduciary responsibility to act in the best interests of their clients and obtain best execution for client transactions may not trade portfolio securities in client accounts in a manner that would benefit the manager at the expense of the client. These obligations are reinforced in the United States with additional compliance and oversight requirements. For example, U.S. fund managers must adopt internal compliance procedures to ensure that soft commission arrangements are not misused, and fund boards are required

<sup>1</sup> The Investment Company Institute is the national association of the U.S. investment company industry. More information about the Institute is available at the end of this letter.

Ms. Pamela Vulpes March 15, 2007 Page 2 of 3 to review a manager's use of soft commissions as part of the annual determination whether to renew a fund management contract.

<sup>2</sup> Limitations on the Use of Soft Commissions. We have supported regulations in the United States limiting the types of services that may be obtained with soft commissions to those that could reasonably be expected to enhance the quality of brokerage and investment services provided to an investment manager's clients.

<sup>3</sup> We believe it is critical that regulations imposed in this regard be made equally applicable to all investment managers, regardless of the type of client account involved. This is important so that all clients (and not just investors in funds) are afforded the same protections relating to

the manager's use of soft commissions. Significantly, it also helps ensure that fund managers are not placed at a regulatory or competitive disadvantage with respect to other types of client accounts. Any regulatory disparity, especially when combined with other forces exerting downward pressure on overall commissions, may create strong incentives for broker-dealers to favor investment managers who are subject to fewer restrictions in their use of soft commissions and whose commission payments may be more lucrative to the broker-dealer. Disclosure. We support appropriate disclosure of soft commission arrangements. We are concerned, however, with approaches that require fund managers to effectively unbundle execution costs from the costs of other services obtained through commission payments without also requiring brokers to provide unbundled information to the managers.<sup>4</sup> An unbundled disclosure obligation placed only on investment managers, without a corresponding obligation on the brokers who provide and price commission services, generates inconsistent disclosure of limited benefit to clients, and may create the potential for client and market confusion rather than the desired improvements in market efficiency and competition. \* \* \* \* The Institute believes that developments over the next few years will confirm the Technical Committee's assessment that soft commission arrangements can be effectively managed to provide valuable benefits to investors. Consequently, we strongly support the Technical Committee's decision to monitor changes in relevant law in various jurisdictions before attempting to develop broadly 2 See Compliance Programs of Investment Companies and Investment Advisers, 68 Fed. Reg. 74714, 74716 (Dec. 24, 2003); Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies, 69 Fed. Reg. 39798, 39808 (June 30, 2004). 3 See, e.g., Letter from Paul Schott Stevens, President, Investment Company Institute, to Mr. Jonathan G. Katz, U.S. Securities and Exchange Commission, dated Nov. 25, 2005 (File No. S7-09-05), available at [http://www.ici.org/statements/cmltr/05\\_sec\\_soft\\_dol\\_com.html](http://www.ici.org/statements/cmltr/05_sec_soft_dol_com.html) 4 See Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Mr. Mark Glibbery, UK Financial Services Authority, dated Jan. 5, 2006 (CP05/13), available at [http://www.ici.org/statements/cmltr/06\\_eu\\_soft\\_dollar\\_com.html](http://www.ici.org/statements/cmltr/06_eu_soft_dollar_com.html) Ms. Pamela Vulpes March 15, 2007 Page 3 of 3 applicable general principles. The additional time and observations will provide the Technical Committee with the information necessary to better assess which regulatory approaches benefit investors and which impose additional burdens on fund managers without corresponding benefits. We appreciate the opportunity to express our views on this important topic. If you have any questions about our comments or would like any additional information, please contact me at +1 202- 371-5430, or Glen Guymon at +1 202-326-5837. Sincerely, /s/ Robert C. Grohowski Robert C. Grohowski Senior Counsel About the Investment Company Institute The Investment Company Institute seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Institute members include 8,839 open-end investment companies (mutual funds), 658 closed-end investment companies, 363 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the Institute have total assets of approximately \$10.445 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households.

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